

REPORT OF STAFF INVESTIGATION OF ENRON CORP.
AND RELATED ENTITIES REGARDING THE
GUATEMALAN POWER PROJECT

Prepared by the Staff of the
COMMITTEE ON FINANCE
UNITED STATES SENATE
CHARLES E. GRASSLEY, *Chairman*
MAX BAUCUS, *Ranking Member*



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INTRODUCTION

On February 15, 2002, Chairman Max Baucus (D-MT) and Ranking Member Charles Grassley (R-IA) announced that the Senate Finance Committee would conduct an investigation into the tax returns of Enron Corp. with the assistance of the Joint Committee on Taxation. (Appendix A). The purpose of the investigation was to review the activities and transactions related to Enron's tax returns and pension and executive compensation programs in order to inform the Finance Committee, the United States Senate, and the American public of the tax policy and administration issues arising out of Enron's circumstances.

The Finance Committee and Joint Committee on Taxation (the Committees) entered into negotiations with Enron and Enron's counsel, Skadden, Arps, Slate, Meagher & Flom LLP, regarding the disclosure of information from the Internal Revenue Service relating to Enron Corp. and related entities. The Disclosure Agreement was signed on March 6 and 7, 2002. (Appendix B). Pursuant to the Disclosure Agreement, Enron agreed to provide copies of all Federal income tax returns and related information to the Committees¹ and consented to the disclosure of such materials through official actions of either committee, including reports, meetings, or hearings of either committee. On April 5, 2002, Enron delivered to the Committee the consolidated tax returns for Enron Corp. and its affiliates for the tax years 1985 through 1995. Additionally, the agreement provided that the IRS could make available the tax returns and return information for Enron Corp. and its affiliates for the tax years 1996 through the present. The IRS has made this information available to the Committees.

On March 25 and 26, 2002, staff of the Committees were briefed by IRS personnel involved with the Enron tax return and pension plan audits in Houston, Texas. During these presentations, members from the IRS Enron audit team described several international projects, including one involving a Guatemalan power plant. The Senate Finance Committee staff report examines this specific Enron project – the Guatemalan power plant project (the Guatemala Project). As directed by the Senate Finance Committee, the Joint Committee on Taxation conducted a broader investigation into Enron's pension and executive compensation arrangements and its structured transactions.

The Finance Committee staff reviewed the Guatemalan power project specifically because of the serious allegations raised by the IRS audit team. The allegations resulted in referrals of possible violations of the Foreign Corrupt Practices Act to the Securities and Exchange Commission and the Department of Justice. Thus, the Guatemala Project provided an opportunity to review the coordination between the IRS and the Federal agencies charged with enforcement of the laws governing corporate misfeasors and corruption. Moreover, documents provided to the IRS by a confidential informant provided a strong indication that improper expenses were claimed on Enron's tax returns, and that company officials had knowledge that such items were inappropriate, but were nevertheless used to reduce Enron's U.S. income taxes.

¹ The Senate Finance Committee requested numerous documents from Enron Corp. Documents provided pursuant to these requests were Bates-stamped with the prefix "EC." Citations to Enron provided documents include the Bates-stamp reference. Additionally, certain footnote sources are reproduced as Exhibits and the Exhibit number is indicated in the footnote.

EXECUTIVE SUMMARY

In 1993, Enron² built a barge-mounted electricity generation plant near Puerto Quetzal, on Guatemala's southern coast, and sold the electricity to a government-sponsored utility. The Guatemalan power project (the Guatemala Project) was Enron's first major Latin American operation and served as a model for future Enron infrastructure projects.³ Enron's initial plan was to focus on power plants, but the plan was later expanded to include gas pipelines and related energy projects.

Enron used U.S. taxpayer support and multilateral organization support to finance the Guatemala Project. The Overseas Private Investment Corporation (OPIC) issued a \$50 million investment guarantee in 2000 to expand the capacity of the plant from 110 megawatts to 234 megawatts.⁴ The World Bank, through its International Finance Corporation (IFC), approved loans of \$71 million.⁵ The U.S. Department of Transportation Maritime Administration (MARAD), financed guarantees on the power barge construction for \$25 million in 1994 and \$73 million in 2000.⁶

After examining this project, IRS international auditors raised a number of questions regarding the proper tax treatment of various project expenses. Specifically, as part of its corporate group, Enron claimed tax deductions attributable to questionable payments made through a subsidiary (Puerto Quetzal Power Corporation (Enron/PQPC)) to a Panamanian corporation known as Sun King Trading Company, Inc. (Sun King) which is owned by four Guatemalans and one U.S. citizen. The payments are not associated with any legitimate service or product associated with the Guatemala Project. Rather, in an effort to conceal taxable income

2 Enron Corp.'s subsidiary, Enron Power Development Corp., took the lead on the Guatemala Project. Enron Power Development Corp. was later succeeded by Enron Development Corp. Throughout the report, "Enron/EDC" is used to refer to Enron Power Development Corp. and Enron Development Corp. See Letter from Thomas E. White to The Honorable Max Baucus and The Honorable Charles E. Grassley (Oct. 8, 2002) (Exhibit 1) [hereinafter Tom White Letter]; Interview of Rebecca P. Mark, in Houston, TX (Oct. 4, 2002); Letter from Richard A. Lammers, Vice President, Enron Power Development Corp. to International Finance Corporation 4 (Feb. 23, 1993 and March 30, 1993 modification letter) (EC2 000036644 through EC2 000036650, Exhibit 2).

3 Officers of Enron/EDC included Thomas E. White, Chairman & Chief Executive Officer, and Rebecca Mark, President. Kenneth Lay, Chairman and Chief Executive Officer, Enron Corp.; Richard Kinder, Chief Operating Officer, Enron Corp.; and the Enron Board of Directors would have approved the capital commitment for the Guatemala Project. *Id.*

4 Sustainable Energy & Economy Network, Institute for Policy Studies, Enron's Pawns: How Public Institutions Bankrolled Enron's Globalization Game 30-31 (March 22, 2002) [hereinafter Enron's Pawns]. See also Letter from Peter S. Watson, President and Chief Executive Officer, Overseas Private Investment Corporation, to The Honorable Max Baucus, Chairman of the Senate Committee on Finance and to The Honorable Charles E. Grassley, Ranking Member of the Senate Committee on Finance 2, Appendix 2B (Feb. 19, 2002) (Exhibit 3) [hereinafter OPIC Letter (Feb.)] (OPIC acknowledged active political risk insurance with Enron equity involvement but did not disclose the amount involved.).

5 Investment Agreement, Puerto Quetzal Power Corp. and International Finance Corporation (Mar. 31, 1993) (EC 000036651 - EC 000036700, Exhibit 4) [hereinafter IFC Investment Agreement].

6 Letter from Bruce J. Carlton, Acting Deputy Maritime Administrator, U.S. Department of Transportation Maritime Administration, to The Honorable Max Baucus, Chairman of the Senate Committee on Finance at 1, 3 (May 22, 2002) (Exhibit 5) [hereinafter MARAD Letter]. See also Enron's Pawns, *supra* note 4, at 30-31.

from the Guatemalan tax authorities, the payments were disguised by Enron as add-on fuel charges, and the monies paid to Sun King were routed to a specified bank account in Miami.

The payments in question also reduced Enron/PQPC's tax liability. Enron classified these payments as an intangible asset and claimed amortization expenses (Internal Revenue Code section 197) of \$333,000 and \$800,000 for tax years 1995 and 1996 respectively.⁷ In 1995, Enron also claimed \$1,534,539 (for the monthly payments of 6% from Enron/PQPC to Electricidad Enron de Guatemala, S.A. (Enron/EEG) for eventual payment to Sun King) as a cost of goods sold (Internal Revenue Code section 162).⁸ The IRS also found, and Enron agreed, that the \$192,681 short-term capital loss claimed on the 1996 sale of Enron/PQPC to Centrans Energy Services (a Cayman Islands company) was a \$1,827,828 short-term capital gain.⁹

⁷ Puerto Quetzal Power Corp. v. Commissioner, Docket No. 17311-99 (Nov. 11, 1999) (Exhibit 6) [hereinafter Tax Court Petition].

⁸ Tax Court Petition, *supra* note 7.

⁹ Department of Treasury - Internal Revenue Service, Notice of Proposed Adjustment To Taxpayer During Examination, Enron Corp. & Subsidiaries 1995 & 1996, Entity: Enron International Inc., Issue No. 127 (May 5, 1999) (The Notice of Proposed Adjustment was signed as "Agreed" by Edward R. Coats, Enron Vice President— Tax, Audits. The agreed to adjustment was for \$2,020,509.) (Exhibit 7) [hereinafter IRS Notice of Proposed Adjustment].

INVESTIGATION SUMMARY

The Guatemalan power project (the Guatemala Project) investigation included interviews of or responses to questions from 15 individuals involved in the Guatemala Project (Appendix C), review of thousands of documents from Enron, the Internal Revenue Service, Department of Justice, Securities and Exchange Commission, Export-Import Bank, U.S. Trade and Development Agency, Overseas Private Investment Corporation, Department of Transportation Maritime Administration, and the World Bank/International Finance Corporation. The investigation also included interviews of officials from the above agencies and organizations.

Based on a review the information provided, the Senate Finance Committee staff has concluded the following with respect to the Guatemala Project:

- 1. Payments made by Enron to a Panamanian corporation were disguised as add-on fuel charges in order to conceal them from U.S. and Guatemalan tax authorities. Enron officials had knowledge that the payments made to the Panamanian corporation exposed it to potential tax liability and penalties. An audit report prepared by Arthur Andersen and internal Enron memoranda confirms that senior Enron officials were aware of the payments and their questionable legality.*
- 2. The U.S. agencies charged with enforcing non-tax criminal laws (the Department of Justice and the Securities and Exchange Commission) failed to act on the non-tax criminal referral made by the Internal Revenue Service (IRS).*
- 3. Enron used World Bank funds and funds from U.S. taxpayer supported agencies and lending organizations to finance the Guatemalan power project as well as the questionable payments to Sun King. The World Bank and the U.S. Department of Transportation Maritime Administration provided financing and the Overseas Private Investment Corporation (OPIC) provided political risk insurance.*
- 4. Bonuses and stock options were awarded when project financing was obtained, rather than upon successful completion of a project.*

SENATE COMMITTEE ON FINANCE STAFF RECOMMENDATION

Federal law enforcement agencies should establish clear procedures for handling Internal Revenue Service referrals of possible non-tax violations.

Federal law enforcement agencies should establish procedures for open communication between the agencies and the IRS to ensure coordinated and comprehensive investigations of cases referred from the IRS. For example, law enforcement agencies should establish written procedures for enforcement personnel to follow to ensure follow-through for proper investigation of IRS referrals. The referral agency should prepare and include within the IRS case file, written confirmation regarding the conclusion or declination of its investigation.

Internal Revenue Code (IRC) section 6103 should not deter the IRS or the referral agency from requesting or receiving relevant information in order for the referral agency to timely, efficiently, and effectively investigate the IRS referral. IRC section 6103 is a complicated and lengthy provision of the tax code that deals with the confidentiality of taxpayer information. The statute provides safeguards and procedures that allow the IRS to share information with a law enforcement agency, and vice versa. Because referrals from the IRS involve taxpayer information, employees of the agency are subject to the criminal and civil sanctions imposed by IRC section 6103. Therefore, the procedures should include a discussion of section 6103 and the ability within such section to access the taxpayer information needed in order to conduct a thorough investigation of possible non-tax violations of Federal law.

SENATE COMMITTEE ON FINANCE STAFF INVESTIGATION

The Finance Committee staff has concluded the following with respect to Enron's Guatemalan power plant project (the Guatemala Project):

I. Disguising Payments for Tax Reporting Purposes

Payments made by Enron to a Panamanian corporation were disguised as add-on fuel charges in order to conceal them from U.S. and Guatemalan tax authorities. Enron officials had knowledge that the payments made to the Panamanian corporation exposed it to potential tax liability and penalties. An audit report prepared by Arthur Andersen and internal Enron memoranda confirms that senior Enron officials were aware of the payments and their questionable legality.

Original Power Contract

The Guatemalan national utility is Instituto Nacional de Electrificación (INDE). INDE owned 91.7% of Empresa,¹⁰ the primary supplier of thermoelectric power to three of the most heavily-populated of Guatemala's departments (Guatemala, Sacatepéquez, and Escuintla).¹¹ INDE sold electricity to Empresa and regulated the generation, distribution, and transmission of electricity in all areas of the country where Empresa did not.¹² Legally, Empresa was a private company and INDE was heavily subsidized by the Guatemalan government.¹³

On January 13, 1992, Texas Ohio Power Co. (TOP), a unit of a Houston-based gas pipeline operator and marketer (unrelated to Enron), signed a 15-year power purchase agreement (PPA)¹⁴ to provide electricity to Empresa Electrica de Guatemala (Empresa). Under the contract, the electricity would come from a 110-megawatt oil-powered, barge-mounted power plant to be built and then sited on two barges at Puerto Quetzal, on Guatemala's southern coast.¹⁵ Empresa was obligated to pay for 110 megawatts of capacity and "to purchase at least 50% of the Guatemala Project's available energy output."¹⁶

10 McCleary, Rachel M., *DICTATING DEMOCRACY: GUATEMALA AND THE END OF VIOLENT REVOLUTION* 98 (University Press of Florida 1999) [hereinafter *DICTATING DEMOCRACY*].

11 *DICTATING DEMOCRACY*, *supra* note 10, at 99.

12 *DICTATING DEMOCRACY*, *supra* note 10, at 98-99.

13 *DICTATING DEMOCRACY*, *supra* note 10, at 98.

14 Memorandum from Enron Power Corp., to the Overseas Private Investment Corporation for use by prospective lenders, Appendix A (Power Purchase Agreement, Empresa Electrica De Guatemala, Sociedad Anonima and Texas-Ohio Power, Inc. (Barbara de Wit, trans.) (Jan. 13, 1992)) (July 1992) (Exhibit 8).

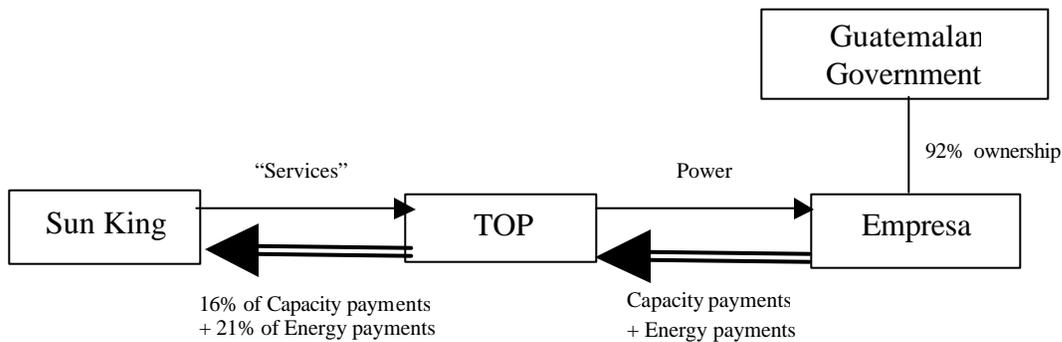
15 Memorandum from Enron Power Corp., to the Overseas Private Investment Corporation for use by prospective lenders, Sections I and IV (Executive Summary of Proposed Transaction and Project Participants) (July 1992) (Exhibit 9) [hereinafter *Enron Memo to OPIC*].

16 *Enron Memo to OPIC*, *supra* note 15, at 6.

On February 24, 1992, TOP signed an Agency Agreement to make substantial payments (16% of the capacity payments and 21% of the energy payments) worth over \$200 million¹⁷ to a group of individuals operating under the business name Sun King Trading Company, Inc. (Sun King).¹⁸ In exchange, the Agency Agreement provided that Sun King “shall make all necessary and other reasonably requested introductions, shall assist in facilitating communications” with Empresa and “shall facilitate negotiations and timely execution of the Power Generation Facility Purchase and Sale Agreement.”¹⁹ Sun King also agreed to make available all information about the purchase and sale agreement, and to “provide all necessary initial and ongoing permits and consents of the Government of Guatemala.”²⁰

The power purchase agreement by and between the Guatemalan national utility (INDE) and a private sector merchant power company (TOP) also involved the third party agent, Sun King. Although Sun King agreed to certain obligations under the Agency Agreement, this did not necessarily translate into actual obligations. A memorandum prepared by Enron’s Guatemalan attorney, Jorge Asensio, stated that “the Sun King payments do not represent any REAL service to Puerto Quetzal Power Corp.”²¹

Power Purchase Agreement



17 Memorandum from Enron Power Corp., to the Overseas Private Investment Corporation for use by prospective lenders, Appendix G, 2 (Cash Flow Puerto Quetzal Power Project) (July 1992) (Exhibit 10) [hereinafter Enron Memo to OPIC Cash Flow].

18 Agency Agreement, Texas-Ohio Power, Inc. and Sun King Trading Company, Inc. (Feb. 24, 1992) (EC2 000034349 – EC2 000034351, Exhibit 11) [hereinafter Agency Agreement]. See also IRS Appellate Transmittal Memorandum and Case Memo 7 (November 03, 2000) (signed Lawrence M. Fagan, Appeals Officer (Sept. 5, 2000); approved James M. Stryker, Associate Chief (Sept. 5, 2000)) (Exhibit 12) [hereinafter Appeals Memo and Case Memo] (Sun King was formed by five prominent Guatemalan businessmen (Oswaldo Mendez Herbruger, Roberto Lopez, Henrik Preuss, Marco Antonio Lara, and Raul E. Arrondo). Sun King was possibly formed to locate independent power companies to participate in privatization of the electric power business in Guatemala. (i.e., the first privately-owned power venture in Guatemala)). See also *Cerigua Weekly Briefs May 2 - 8, 1993: Government Retreats on Rate Hike*, CERIGUA, May 10, 1993, at 4 (After the 1992 negotiations, a brother to Oswaldo Mendez Herbruger (an owner of Sun King) was appointed Assistant Finance Minister for Privatization, and had announced in May 1993, an eighteen month plan to sell the majority of state-owned enterprises.); *Cerigua Weekly Briefs June 13 - 19, 1993: Herbruger Voted Vice President*, CERIGUA, JUNE 21, 1993 (Additionally, on June 18 1993, Mr. Herbruger’s great -uncle was selected as Guatemala’s new vice president.).

19 Agency Agreement, *supra* note 18.

20 Agency Agreement, *supra* note 18, at 2.

21 Memorandum from Jorge Asensio A., to James J. Steele and Bill Coy 2 (Feb. 26, 1993) (EC2 000036550 – EC2 000036553, Exhibit 13) [hereinafter Asensio Memo I].

Intermediate Structure of the Transaction

TOP had a 60-day window to arrange commitments for financing the Guatemala Project. In the final days before TOP's 60-day window was set to expire, developers employed by TOP, Enron, King Ranch Power Corporation (King Ranch), and Wärtsilä Diesel were in Guatemala negotiating with Sun King. The night before TOP's contract rights were set to expire, Enron developer David Haug, accompanied by Sun King owners, informed the competing parties that Enron would agree to start construction of the power barge and seek non-recourse financing while the Guatemala Project proceeded to commercial start-up. Additionally, Enron agreed to pay Sun King a compensation package based on Project gross revenues.²²

On March 12, 1992, Mr. Haug presented TOP with the following three documents for signature:

1. Agreement by and between TOP and Enron Power Development Corp. (Enron/EDC) to transfer the Power Purchase Agreement to Enron/EDC for the following consideration:
 - \$100,000 within three business days;
 - \$100,000 by December 1, 1992;
 - \$100,000 reimbursement for expenses;
 - 6 percent of the monthly gross revenues generated under the PPA;
 - \$700,000 on the date of first commercial operation under the PPA; and
 - \$700,000 180 days after the date of first commercial operation.²³
2. Amendment to the TOP/Sun King Agency Agreement dated February 24, 1992, stating that (1) Sun King (Agent) is no longer empowered to act on behalf of TOP (Principal) and (2) TOP is to pay Sun King an amount monthly equal to 6 percent of the gross revenues generated by sales of electricity and payments for capacity under the PPA dated January 13, 1992.²⁴
3. Letter addressed to Enron stating that TOP transfers its right to receive a monthly payment of 6 percent to Sun King.²⁵

22 See Interview of Jude Patrick LaStrapes, in Winnebago, Wis. (July 17, 2002) (Former President of Texas-Ohio Power) [hereinafter LaStrapes Interview]; See also Interview Diego (Dean) C. Rojas, in Houston, Tex. 12 (August 7, 2002) (Mr. Rojas was the Manager of Acquisitions, King Ranch) (According to Mr. Rojas, the Enron concessions "blew-away" the competing bids.) [hereinafter Rojas Interview].

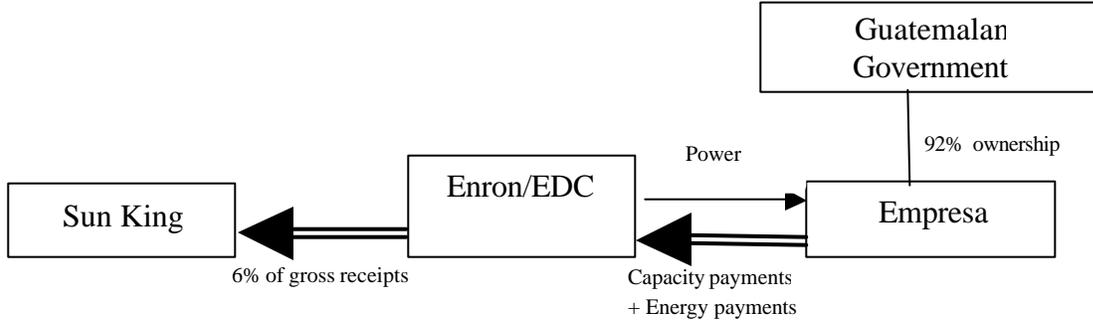
23 Agreement, Texas-Ohio Power, Inc. and Enron Power Development Corp. (Mar. 12, 1992) (EC2 000034376 – EC2 000034378, Exhibit 14).

24 Amendment to That Agency Agreement Dated February 24, 1992, Texas-Ohio Power, Inc. and Sun King Trading Company, Inc. (Mar. 12, 1992) (EC2 000034347 – EC2 000034348, Exhibit 15).

25 Letter from Patrick LaStrapes, President, Texas-Ohio Power, Inc., to David L. Haug, (Mar. 12, 1992) (EC2 000034379, Exhibit 16) [hereinafter TOP Transfer Letter]. See also Letter from David Haug, Managing Director, Enron Power Development, Corp., to Patrick LaStrapes, President, Texas-Ohio Power, Inc. (Mar. 12, 1992) (EC2 000034380, Exhibit 16); Letter from David Haug, Managing Director, Enron Power Development, Corp., to Sun King Trading Company, Inc. (Mar. 12, 1992) (EC2 000034381, Exhibit 16).

Thus, the PPA by and between the Guatemalan national utility and TOP was amended as follows:

Amended Power Purchase Agreement



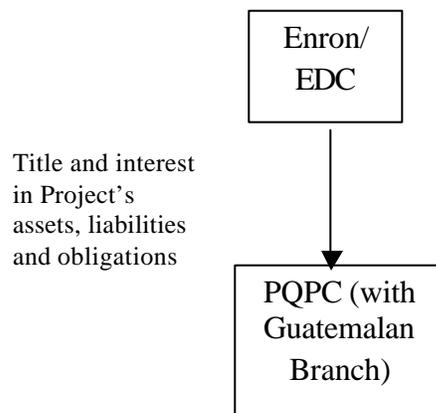
The payments Enron agreed to make would at least represent some compensation for the value TOP created in securing the PPA, and would serve to reimburse TOP for some of its out-of-pocket expenses. Patrick LaStrapes, TOP’s President, claimed that he signed the three documents because it was clear to him that the PPA would be awarded to Enron. However, Mr. LaStrapes could not explain why the three documents were drawn to give the appearance that 6 percent of the Guatemala Project’s monthly gross revenue was due to TOP, and that TOP had agreed to assign its rights to this 6 percent revenue stream to Sun King. Mr. LaStrapes maintains that Enron had engaged in unilateral negotiations with Sun King and reached a separate agreement to compensate Sun King with 6 percent of the Guatemala Project’s gross revenues.²⁶ Nonetheless, the uncertainty surrounding Sun King’s role in the deal raises the issue of the legitimacy of the 6 percent payments.

²⁶ LaStrapes Interview, *supra* note 22.

Final Structure of the Transaction

Enron used its subsidiaries and a public limited partnership to transfer money and ownership interests in the Guatemalan Project.

To build, own, and operate the power barge at Puerto Quetzal, Enron Development Corp. (Enron/EDC) formed a U.S. subsidiary with a Guatemalan branch known as Puerto Quetzal Power Corp. (Enron/PQPC).²⁷ The ownership structure was designed to retain U.S. flag registry on the two power barges.²⁸ On November 13, 1992, Enron/EDC transferred to Enron/PQPC all of Enron/EDC's title and interest in the Guatemala Project's assets, and all of Enron/EDC's liabilities and obligations attaching to the Guatemala Project's assets.²⁹



²⁷ Enron Memo to OPIC Cash Flow, *supra* note 17.

²⁸ Interview of Ron Teitelbaum, in Houston, Tex. (September 17, 2002) (Mr. Teitelbaum was the Tax Manager, Enron Corp.) (Furthermore, subsequent international power projects were structured through tax haven ownership.).

²⁹ Assignment and Assumption Agreement, Enron Power Development Corp. and Puerto Quetzal Power Corp., Guatemala Branch (Nov. 13, 1992) (EC2 000034409 – EC2 000034412, Exhibit 17).

After the Puerto Quetzal power plant project began commercial operations in February 1993, Enron received a letter (dated March 1, 1993) from Sun King.³⁰ Sun King requested that “monthly payments of 6.0 percent of the gross revenues generated by the sale of electricity and payment of contract capacity . . . be sent/transferred to our banks: Deutsch-Suedamerikanische Bank AG, Miami Agency.”³¹ On March 3, 1993, Sun King represented its right to receive 6 percent of the Guatemala Project gross revenues as “inherited” by Enron from TOP.³² Sun King also objected to any of the monthly payments made net of Guatemalan taxes.³³

In the same month, Guatemala’s President Serrano proposed a very controversial increase in electrical rates, with disastrous consequences. On top of a 47% rate increase in August 1991, and another 20% rate increase in September 1992, President Serrano proposed, in February 1993, to raise rates again. The rate increase was another 47% on average, but as much as 400% for some customers, according to the Guatemalan human rights ombudsman.³⁴

The President of Congress recommended that Guatemalans not pay their electric bills, and the human rights ombudsman filed an injunction to block the rate increase due to its effects on the poor in Guatemala. Riots ensued throughout the spring of 1993. Those riots, along with political differences over the rate increases, led to President Serrano’s failed attempt to take over the government in May 1993, and his subsequent ouster.³⁵ It was in this environment that Enron apparently worked to conceal its deal with Sun King from the public.

On March 31, 1993, Section 1.29 of the original agreement (November 13, 1992) Project Operation and Maintenance Agreement between Enron/PQPC (Project owner) and Electricidad Enron de Guatemala (Enron/EEG) (Project operator) was deleted in its entirety and replaced with a provision that included fuel oil as a reimbursable expense.³⁶ The next day, Enron/EEG and Enron Power Oil Supply Corp.(Enron/EPOS) entered into a Fuel Supply and Maintenance Agreement. The fuel supply agreement provided that Enron/EEG would pay or cause to be paid to Enron/EPOS “an amount equal to six percent of the gross monthly revenue of Puerto Quetzal (‘the monthly fee’)” in addition to the amounts necessary to reimburse Enron/EPOS for its payments to its supplier for fuel.³⁷ Thus, the 6 percent payments flowed from Enron/PQPC, to Enron/EEG, to Enron/EPOS, and finally to Sun King.

30 Oswaldo Mendez Herbruger, President, Sun King Trading, Inc., to David Haug, (Mar. 1, 1993) (EC2 000036565, Exhibit 18) [hereinafter Herbruger Memo Mar. 1].

31 Herbruger Memo Mar. 1.

32 Oswaldo Mendez Herbruger, President, Sun King Trading, Inc., to David Haug, (Mar. 3, 1993) (EC2 000036566 – EC2 000036567, Exhibit 19) [hereinafter Herbruger Memo Mar. 3].

33 Herbruger Memo Mar. 3, *supra* note 32.

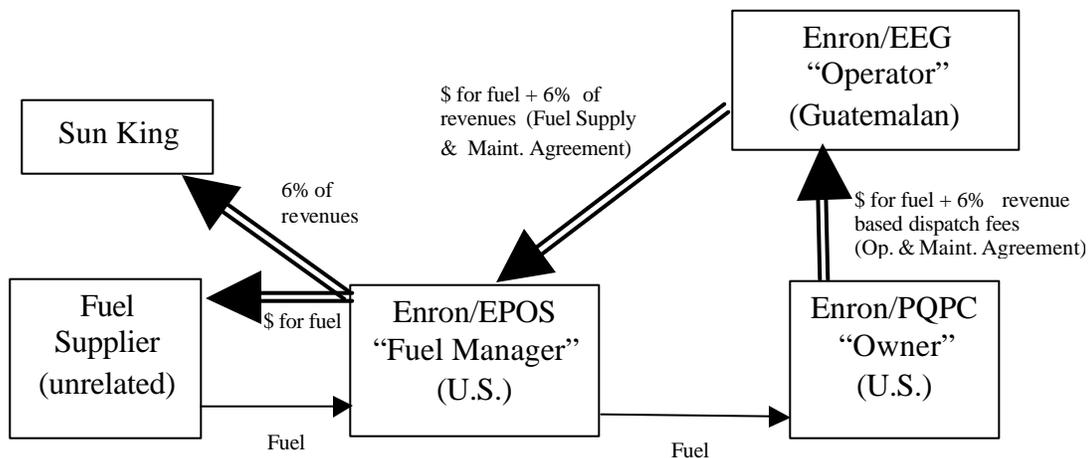
34 *Cerigua Weekly Briefs April 25 – May 1, 1993: Power Rate Hike Sparks Protests*, Cerigua, May 3, 1993.

35 *DICTATING DEMOCRACY*, *supra* note 11, at 97-149.

36 Operation and Maintenance Agreement and Amendments, Puerto Quetzal Power Corp., Guatemala Branch and Electricidad Enron De Guatemala, S.A. (Nov. 13, 1992; amended Mar. 31, 1993; Aug. 22, 1995; and Dec. 31, 1995) (EC2 000034527 – EC2 000034575, Exhibit 20) (Puerto Quetzal Power Corp., Guatemala Branch was the Owner and Electricidad Enron De Guatemala, S.A. was the Operator).

37 Fuel Supply and Maintenance Agreement, Electricidad Enron De Guatemala, S.A. and Enron Power Oil Supply Corp., (Apr. 1, 1993) (EC2 000034352 – EC2 000034357, Exhibit 21) (Electricidad Enron De Guatemala, S.A. was the Operator).

Fuel/Supply Agreement



Questionable Legality of the Payments

On April 12, 1993 and May 13, 1993, \$219,330.27 and \$256,696.09, respectively, were wire transferred from Enron/EPOS to Sun King's designated Miami bank.³⁸ Enron knew that this arrangement presented problems. An Enron memo stated, "this 6% amount is still a separate item of payment and, as described in the contract, is subject to a 1% limitation (as well as a 25% withholding tax and the 3% stamp tax)."³⁹ The memorandum also described the enormous markup that would be required if the 6 percent were billed as part of the fuel price and not as a separate fee.⁴⁰

Apparently, Enron struggled to meet the demands of Sun King. Sun King insisted on payment in U.S. dollars outside of Guatemala and free of Guatemalan taxes.⁴¹ Enron was not obligated by its contract to pay as Sun King requested.⁴² Several Enron memoranda document

38 Enron Power Corp. Memorandum from Carl Waldo, to David Odorizzi 4 (May 26, 1993) (EC2 000036574-EC2 000036577, Exhibit 22) [hereinafter Enron/Waldo Memo]; See also Accounting Documents relating to payments tendered by EEG to EPOS, Enron response to Senate Finance Committee (September 18, 2002) (EC 001911594-EC 001911595, Exhibit 23). Cf. Interview with Richard A. Lammers, President, Global Energy Advisors, in Houston, Tex. (August 8, 2002) (Mr. Lammers was the Treasurer of Puerto Quetzal Power Corp.) [hereinafter Lammers Interview] (Mr. Lammers denied any knowledge of authorizing payments to Sun King.).

39 Enron/Waldo Memo, *supra* note 38, at 3.

40 Enron/Waldo Memo, *supra* note 38, at 3.

41 See Enron/Waldo Memo, *supra* note 38; Memorandum from Jorge Asensio A., to David Odorizzi 2 (Dec. 13, 1993) (Exhibit 24) [hereinafter Asensio Memo II]; Herbruger Memo Mar.3, *supra* note 32; Enron Corp. Memorandum from Ron Teitelbaum, to David Haug, Rick Lammers, David Shields, Eric Wycoff, and Rob Walls (March 12, 1993) (EC2 000036568-EC2 000036569, Exhibit 25).

42 See Asensio Memo I, *supra* note 21; Enron/Waldo Memo, *supra* note 38; Asensio Memo II, *supra* note 41; Memorandum from Bill Leggatt, to Roberto Figueroa, Bill Votaw, Vinicio Urdaneta, Chuck Emrich, and Ron Teitelbaum, (Feb. 6, 1995) (Exhibit 26) (See List of Interviews, Appendix C, regarding positions held at Enron Corp. or its affiliates.).

the many questions of how to pay Sun King, including whether or not the Sun King obligation was a liability of Enron/EDC or of Enron/PQPC, how to make the payments (in dollars or Guatemalan quetzales), to what bank (Guatemalan or foreign), and how to represent the payments (e.g., as a commission or a royalty, and for what type of services). Enron's Guatemalan attorney, Jorge Asensio, described the difficulties of making such payments legally, and advised not to cede to Sun King's demands.

The memoranda also show that Enron officials knew there were legal problems in describing the payments in any legitimate way. Mr. Asensio stated, "the Sun King payments do not represent any REAL service to Puerto Quetzal Power Corp."⁴³ The only real service that Sun King performed was to "introduce Texas Ohio to President Serrano, and talked him into signing the contract. It is the typical 'finder fee' arrangement, with the only difference that the fee was – for that service – completely out of hand."⁴⁴ Mr. Asensio advised Enron that the payments could not be listed as a commission because, legally, a commission must be one-time rather than ongoing, and must be justified by the nature of the transaction.⁴⁵ Another Enron memorandum showed that Enron knew the payments could not be considered a royalty, because under Guatemalan law a royalty can not exceed 5 percent and is limited to payment for certain purposes.⁴⁶

An internal Enron memorandum, dated May 26, 1993, detailed a number of potential alternative methods of payment, each of which was acknowledged to have legal, tax, or other problems, and noted that the payments "could not qualify as a 'royalty' as defined in the law."⁴⁷ Another internal Enron memorandum, dated November 17, 1993, stated that "the system of making dispatch payments to our Guatemalan O&M company ('EEG') and then EEG making a brokerage and handling payment for fuel delivered from other Enron affiliates was adopted in order to find a way to make the Sun King payment fully deductible in Guatemala and avoid having to gross-up the 25% Guatemalan withholding tax on such payments."⁴⁸

By December 1993, however, another memorandum from Mr. Asensio indicated that Enron was still searching for alternatives for the Sun King payments and was considering a buy-out of the obligation based on its net present value,⁴⁹ an approach that had been raised but not pursued in the May 26 Enron memorandum.⁵⁰ Mr. Asensio stated in his December 1993 memorandum that "Sun King did not deliver all the offerings, representations or promises made during the negotiations."⁵¹ Thus, both Mr. Asensio and Mr. Waldo advised Enron not to agree to Sun King's after-the-fact insistence on receiving dollars, outside of Guatemala, not subject to

43 Asensio Memo I, *supra* note 21, at 2.

44 Asensio Memo II, *supra* note 41, at 2.

45 Asensio Memo I, *supra* note 21, at 3.

46 Enron/Waldo Memo, *supra* note 38, at 2.

47 Enron/Waldo Memo, *supra* note 38, at 2-4.

48 Enron Corp. Memorandum from Ron Teitelbaum, to David Odorizzi 2 (Nov. 17, 1993) (EC2 000036586-EC2 000036589, Exhibit 27).

49 See Asensio Memo II, *supra* note 41. Cf. Interview David H. Odorizzi, Executive Vice President and Chief Financial Officer, EnLink Geoenery, in Houston, Tex. (August 8, 2002) (Mr. Odorizzi could not recall details of the buy-out offers made Sun King group.).

50 Enron/Waldo Memo, *supra* note 38.

51 Asensio Memo II, *supra* note 41, at 2.

withholding.⁵² Nonetheless, Enron used an arrangement to move funds in a way that complied with Sun King's request to be paid in U.S. dollars and to hide them from Guatemalan tax authorities.⁵³

A March 10, 1995 internal audit prepared by Arthur Andersen for Enron/PQPC found that: [the] practice of paying Sun King's fee through the fuel payment to EPOS on a tax free basis exposes EEG (Electricidad Enron de Guatemala) to a potential tax liability, including penalties. The price paid for fuel by EEG to EPOS is more than the price charged by EEG to PQPC as a reimbursable expense. The difference would be evident and would warrant an explanation to Guatemalan officials if exposed.⁵⁴

The Arthur Andersen audit report further states that:

the payment to Sun King represents a commission payment to a corporation not domiciled in Guatemala. As such, there are specific taxes required by Guatemalan law to be withheld, and significant penalties (including criminal) for failure to do so. Based on total fees made to Sun King to date, a potential liability of approximately \$1.6 million (not including compensatory interest) exists for 1994. This liability could approach \$2.9 million by 1995 year end.⁵⁵

Finally, on March 31, 1993, Enron/EDC sold 50 percent of its shares of Enron/PQPC to King Ranch Power for \$14.9 million.⁵⁶

52 See Asensio Memo I, *supra* note 21, at 2; Enron/Waldo Memo, *supra* note 38, at 2-3.

53 Enron/Waldo Memo, *supra* note 38, at 2.

54 Arthur Andersen LLP, Puerto Quetzal Power Corp. Summary of Audit Findings 12 (March 10, 1995) (EC 001918781-EC 001918794, Exhibit 28) [hereinafter Andersen Audit].

55 Andersen Audit, *supra* note 54, at 12.

56 Project Participation Agreement, King Ranch Power Corp. and Enron Development Corp. (Mar. 31, 1993) (EC2 000034460-EC2 000034507, Exhibit 29); See also Felton McL Johnston, Vice President for Insurance, Overseas Private Investment Corporation, to Paul E. Parrish, Risk Management Analyst, Enron Corp. 1 (April 28, 1993) (Exhibit 30); Rojas Interview, *supra* note 22. (The 15-year Project net income stream was still attractive and within targets set by the King Ranch Power's Board of Directors for asset acquisitions. Thus, King Ranch Power bought back into the Project once it was in commercial operation.).

The \$12 Million Buy-Out

It was in the May 1993 timeframe when Enron/EDC opened formal discussions with Sun King regarding a buy-out of their gross profits interest in the Guatemala Project. Enron/EDC dispatched James J. Steele (one of the three initial Enron/EDC developers involved in the 1992 negotiations) to meet with Sun King. Sun King dismissed Mr. Steele's counter offer as too low.⁵⁷ Instead, on September 27, 1993, Sun King proposed buy-out offers ranging between \$17 million and \$34 million.⁵⁸ The buy-out was calculated "based on the present value of our [Sun King's] contract with Enron Power Development Corp."⁵⁹ Sun King stated, "we would like to remind you that our payments were negotiated from the beginning of the project so that they are net figures not subject to withholding of any taxes."⁶⁰ Furthermore, Sun King suggested that Mr. Steele reconsider his offer "to more closely reflect a fair compensation for our group in return for forfeiting payments on the present contract between PQPC and Empresa Electrica de Guatemala, S.A."⁶¹

Sun King did not want to deal further with Mr. Steele.⁶² The next Enron/EDC employee sent to negotiate with Sun King was David Odorizzi. In a January 28, 1994 memorandum, David Odorizzi stated "some good strategic reasons" for attempting another buy-out of Sun King, including that "[t]he relationship between Sun King and the former regime could prove embarrassing."⁶³ Another reason was that "[a]t this time, Sunking's [sic] political influence is fairly low, and in practical terms Sunking [sic] seems reluctant to flex any political muscle they have left to help the project."⁶⁴ Mr. Odorizzi proposed a buy-out offer of \$10 million, "conditional on Enron Board approval and acceptable financing," and capped by a \$15 million ceiling.⁶⁵ On March 16, 1994, Mr. Odorizzi presented Sun King with a written buy-out offer of \$10 million "effective date 1 January 1994."⁶⁶ Although Sun King considered Mr. Odorizzi's approach more low key than that of Mr. Steele, they rejected Mr. Odorizzi's buy-out offer, and presented Enron Power Corp. (the direct parent of Enron/EDC) with a \$15 million counter

57 Interview with William A. Coy, Engineer, in Manassas, Va. (July 24, 2002) (Former developer of Enron Power Development Corporation) [hereinafter Coy Interview].

58 Letter from Oswaldo Mendez Herbruger, President, Sun King Trading Inc., to James Steel [sic], Enron Power Corp. (Sept. 27, 1993) (EC2 000036580-EC2 000036581, Exhibit 31) [hereinafter Herbruger Letter Sept.].

59 Herbruger Letter Sept., *supra* note 58, at 1.

60 Herbruger Letter Sept., *supra* note 58, at 2.

61 Herbruger Letter Sept., *supra* note 58, at 2.

62 According to a former Enron executive, Sun King was irritated with Mr. Steele's demand to be treated as a dignitary. Mr. Steele requested limousine service and the Presidential suite. Mr. Steele was informed that the only limousine in Guatemala was used only for weddings and funerals. *See* Coy Interview, *supra* note 57; Interview with Raul E. Arrondo, President, Grove Energy Systems, L.L.C., in Miami, Fla. (August 6, 2002) [hereinafter Arrondo Interview]. *Cf.* Interview James J. Steele, President and CEO, TM Power Ventures L.L.C., in The Woodlands, Tex. (July 18, 2002) (Mr. Steele was a principal/developer of Enron Power Development Corporation.) (Mr. Steele could not recall any details of any of the 1993 meetings and offers to Sun King.).

63 Memorandum from David Odorizzi, to Rod Gray 1 (Jan. 28, 1994) (EC2 000036593, Exhibit 32) [hereinafter Odorizzi/Gray Memo].

64 Odorizzi/Gray Memo, *supra* note 63, at 1.

65 Odorizzi/Gray Memo, *supra* note 63, at 2.

66 Enron International Inc. Letter from David H. Odorizzi, President International Business Ventures, to Messrs. Sun King Trading Company, Inc. (Mar. 16, 1994) (EC 001918602-EC 001918603, Exhibit 33).

offer.⁶⁷ By December 31, 1994, an agreement to buy-out Sun King had still not been reached. Sun King received monthly payments totaling \$4.8 million since April 1993. Sun King received another \$750,000 in payments from January 1995 through March 1995.⁶⁸

Two significant events transpired prior to Enron's August 1995 buy-out of Sun King. First, Enron sold a 50 percent equity interest in Enron/PQPC as an asset in the initial public offering of Enron Global Power & Pipelines L.L.C. (Enron/EPP), a public limited partnership.⁶⁹ Second, Enron reacquired the 50 percent equity interest in Enron/PQPC held by King Ranch Power.⁷⁰

67 Letter from Oswaldo Mendez Herbruger, President, Sun King Trading Inc., to Messrs. Enron International Inc. (Mar. 16, 1994) (EC 001918604-EC 001918606, Exhibit 34) [hereinafter Herbruger Letter March]; *See also* Arrondo Interview, *supra* note 62, Coy Interview, *supra* note 57.

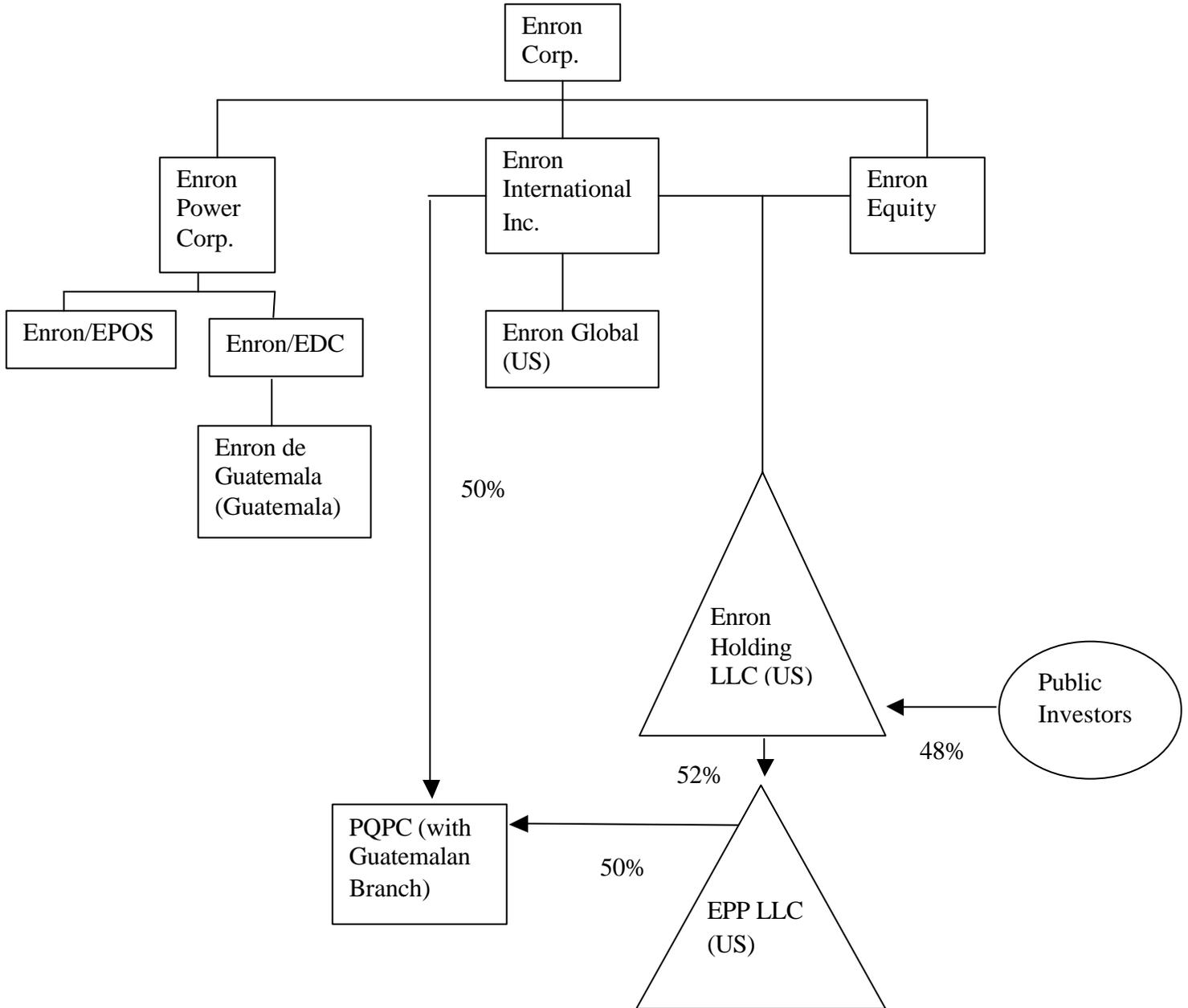
68 Electricidad Enron de Guatemala, S.A., B& H Charges Vs. Commission Payments, Enron response to Senate Finance Committee (September 18, 2002) (EC001911596, Exhibit 35) ("Reconciliation of Payments made to Sun King vs B&H Chg Received from EEG").

69 Enron Global Power & Pipelines L.L.C. (EPP) was formed in November 1994, to own some of Enron's power and pipeline assets in developing countries. At formation, Enron included 50% of the outstanding stock of Puerto Quetzal Power Corporation as one of the Projects vended into EPP. *See* Form 10-K, Annual Report, Enron Corp. and Subsidiary Companies (fiscal years ended Dec. 31, 1994 and Dec. 31, 1995) (At August 22, 1995, Enron remained a 52% partner in EPP.), at <http://www.sec.gov/Archives/edgar/data/72859/0000072859-95-000014.txt> [hereinafter Form 10k].

70 On December 16, 1994, King Ranch Power exercised an option under an existing agreement with Enron/EDC, and sold its 50 percent common stock interest in Enron/PQPC to Enron/EDC's designee Enron International, Inc. (Enron/EII) for cash of \$15.2 million. *See* Stock Purchase and Related Transactions Agreement, King Ranch Power Corp., King Ranch Oil and Gas, Inc., Enron Corp., Enron Development Corp., Enron International Inc., Enron Global Power & Pipelines L.L.C., Electricidad Enron De Guatemala S.A. (Dec. 16, 1994) (EC2 000034508-EC2 000034513, Exhibit 36); *See also* Rojas Interview, *supra* note 22 (The King Ranch Board had taken exception to the economic performance of assets recommended and purchased by Mr. Rojas and his immediate supervisor. Thus, the decision was made to liquidate the interest King Ranch Power held in these assets.).

As a result, by August 1995, Enron and its affiliates appeared to hold the common stock interest in Enron/PQPC, as depicted in the following chart:⁷¹

Enron Corporate Structure



71 IRS Notice of Proposed Adjustment, *supra* note 9; See also Form 10-K, *supra* note 69.

With Enron/PQPC now owned partially by the public, Enron utilized \$6 million of funds from Enron/EPP (the public partnership) to fund 50 percent of the Sun King buy-out.⁷² This was apparently not Enron's only use of public partnership monies.⁷³ Enron used Enron/EPP to fund Enron Corp. obligations.⁷⁴ Additionally, Henrik Preuss (one of the owners of Sun King and owner of Centrants) was given a preferential right of first refusal to negotiate the purchase of a 50 percent equity interest in Enron/PQPC.⁷⁵

On August 22, 1995, a "Termination and Release Agreement" was executed by and between Enron/EDC, Sun King, and Centrants International Sociedad Anonima (Centrants),⁷⁶ and \$12 million was wire transferred for credit to Centrants at Deutsch-Suedamerikanische Bank Ag., Miami Agency.⁷⁷ The Termination agreement provided, in part, that:

1. Sun King would transfer its right to receive monthly payments to Centrants;
2. Enron/EDC would pay Centrants \$12 million; and
3. Sun King would release Enron/EDC and its affiliates from any and all obligations to make monthly payments that accrue on or after August 1, 1995.

On January 9, 1996, Enron International Inc. (domestic brother-sister to EDC) (Enron/EII) sold its 50 percent interest in the outstanding stock of Enron/PQPC (reacquired from King Ranch Power) to Centrants for \$16 million cash and a promissory note for \$7,220,508.⁷⁸ The promissory note reflected that \$16 million in cash was all that could be raised by January 9, 1996.⁷⁹

72 Wire Transfer Request, Enron Global Power & Pipeline L.L.C., to Centrants Internacional, S.A. (Aug. 22, 1995) (EC2 000034600-EC2 000034602, Exhibit 37) [hereinafter Wire Transfer]. See also; Form 10-K, *supra* note 69.

73 Telephone Interview with James Alexander, (October 17, 2002) (Former Senior Vice President and Chief Financial Officer of Enron Power & Pipeline L.L.C.) [hereinafter Alexander Interview].

74 Alexander Interview, *supra* note 73; See also Loren Steffy & Adam Levy, *Enron's Original Sin*, BLOOMBERG, April 2002, at 34.

75 Rojas Interview, *supra* note 22.

76 Termination and Release Agreement, Enron Development Corp., Sun King Trading Company, Inc., and Centrants Internacional, S.A. (Aug. 20, 1995) (EC2 000034382-EC2 000034386, Exhibit 38).

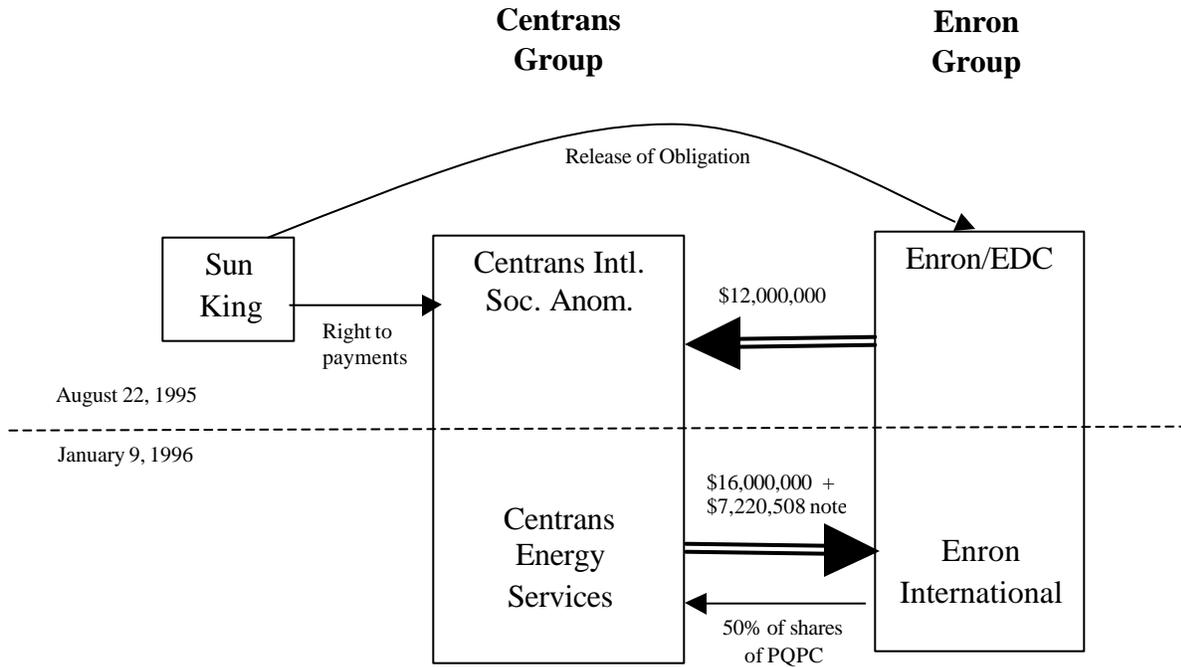
77 Wire Transfer, *supra* note 72. See also Arrondo Interview, *supra* note 62; Rojas Interview, *supra* note 22; Interview with David Haug, Principal, The Haug Group, in Houston, Tex. (July 18, 2002) (Mr. Haug was the Managing Director, Enron Development Corporation.) [hereinafter Haug Interview] (Neither Mr. Arrondo nor Mr. Haug could recall how the \$12 million figure was derived, or provide any details regarding how resolution progressed from Sun King's 1993 \$30 million initial asking price.).

78 Stock Sale Agreement, Enron International Inc. and Centrants Energy Services, Inc. (Jan. 9, 1996) (Exhibit 39). See also Presentation of the: Centrants Group, Provided to the Overseas Private Investment Corporation (not dated) (Exhibit 40 is on file with the Senate Finance Committee) (Centrants Energy Services, Inc. was profiled as a Centrants group affiliate and the Centrants Group was noted as playing a vital role in the installation of the Enron/PQPC power project.).

79 Rojas Interview, *supra* note 22 (Following Diego Rojas's employment with King Ranch Power he was hired by Henri Preuss (the owner of Centrants and one of the Sun King owners) to negotiate the purchase of the 50 percent equity interest in Enron/PQPC. Mr. Rojas believed that the purchase price was a good deal for Centrants (i.e., 50 percent of Enron/PQPC's book value). Mr. Rojas was unaware of the source of the \$16 million.).

The Sun King termination payment and the subsequent purchase of a 50 percent equity interest in Enron/PQPC by Centrans Energy Services resulted in the following corporate relationship:

The Enron/Centrans Corporate Relationship



Thus, the buy out of the obligation to Sun King appears to have been orchestrated through a series of transactions involving Enron subsidiaries, interconnected corporations via common owners, and the use of public partnership monies. Enron went to great lengths, using numerous entities, to disguise the periodic payments made to Sun King and the buy-out payments made to Sun King in order to characterize the payments as a corporate tax deduction.

II. Lack of Coordination Among U.S. Federal Agencies.

The U.S. agencies charged with enforcing non-tax criminal laws (the Department of Justice and the Securities and Exchange Commission) apparently failed to act on the non-tax criminal referral made by the Internal Revenue Service (IRS).

Under the Foreign Corrupt Practices Act (FCPA), it is illegal for a U.S. company to pay foreign officials for the purpose of obtaining or keeping business. It is also illegal to make payments to a third party, while knowing that all or a portion of the payment will go directly or indirectly to a foreign official. U.S. companies are expected to exercise due diligence and take precautions in developing business relationships to avoid being held liable for corrupt third-party payments.⁸⁰

The Department of Justice (DOJ) is responsible for enforcement of these provisions of FCPA. The Securities and Exchange Commission (SEC) plays a coordinating role, enforcing other provisions that require companies to keep accurate records and to maintain accounting systems that assure management's control over assets and taking certain actions against individuals or firms charged or convicted of FCPA violations.

Internal Revenue Service Actions

The IRS is an organization with 100,000 employees worldwide. If a taxpayer is under IRS audit, he typically deals with a Revenue Agent from the IRS Examination division. If the taxpayer disputes the decision of the Revenue Agent, the taxpayer may file a petition with the United States Tax Court or ask for the IRS Appeals division to review the case. The IRS Criminal Investigation Division (CID) investigates violations of the tax laws.

The size and complexity of the IRS organization and mission may have contributed to the apparent delay in investigating Enron's questionable payments to Sun King. Specifically, Enron/PQPC's classification of the payments to Sun King occurred four years before the IRS investigation and referral to the DOJ and SEC.

On March 31, 1995, the Houston, Texas division of the IRS CID interviewed a confidential informant, who provided four Enron memoranda.⁸¹ Houston CID forwarded their findings to the Houston Examination division on December 12, 1995.⁸² The following timeline tracks IRS actions regarding the audit of Enron's questionable payments to Sun King:

80 U.S. DEP'T OF JUSTICE, FOREIGN CORRUPT PRACTICES ACT ANTI-BRIBERY PROVISIONS (Mar. 15, 2002), at <http://www.usdoj.gov/criminal/fraud/fcpa/dojdocb.htm>; See also Michael V. Seitzinger, Congressional Research Service, American Law Division, *Foreign Corrupt Practices Act*, RL30079 (Mar. 3, 1999) (This report includes the history and analysis of the 1977 Foreign Corrupt Practices Act (FCPA) and the 1988 amendments to FCPA.).

81 Gerald A. Richards, International Examiner, Internal Revenue Service (September 23, 2002) [hereinafter IRS Timeline].

82 IRS Timeline, *supra* note 81.

June 17, 1997	Examination team leader evaluates the informant's information
July 8, 1998	Enron/PQPC's 1996 tax return is pulled from "unopened" inventory
July 16, 1998	International Examiner interviews informant
July 30, 1998	Tentative decision to open 1995 Enron/PQPC tax return for separate audit
August 10, 1998	Decision to delay opening; consent given to develop facts as an issue surrounding the Enron Corp. 1995 and 1996 tax returns but not as a separate audit, thus limiting the type of information requested.
March 16, 1999	Request to Houston District Disclosure Office to make referrals to DOJ and SEC regarding potential violation of FCPA
March 16, 1999	Houston District Counsel authorizes further development of issues
May 5, 1999	Notice of Proposed Adjustments presented to Enron Corp. ⁸³
May 1999	IRS makes referrals to DOJ and SEC

On examination of Enron's tax returns, the IRS identified the transactions related to Sun King and Centrans as questionable with respect to their tax treatment. The IRS disallowed the \$333,000 and \$800,000 amortization expenses (under IRC section 197) that Enron claimed in 1995 and 1996 for the \$12 million payment to Centrans.⁸⁴ The IRS also disallowed the deduction of the \$1,534,539 as cost of goods sold (under IRC section 162) in 1995 (the monthly payments of 6 percent from Enron/PQPC for eventual payment to Sun King), arguing that the expense was not an ordinary and necessary business expense.⁸⁵ The IRS also argued, and Enron agreed, that the \$192,681 short-term capital loss claimed on the 1996 sale of Enron/PQPC to Centrans was a \$1,827,828 short-term capital gain.⁸⁶

On November 12, 1999, Enron's counsel, Vinson & Elkins, filed a petition with the United States Tax Court for 1995 and 1996 tax deficiencies determined by the IRS for Enron/PQPC in the amounts of \$375,368 and \$160,000, respectively.⁸⁷ On December 21, 1999, the IRS's Houston District Examination Division responded in writing to Enron's Tax Court Petition.⁸⁸ The IRS's Houston District Counsel referred the case docket to the IRS's Houston District Appeals division. The Appeals division decided not to pursue the deficiencies. In light of the fact that Appeals determined the IRS could not use the four memoranda from Enron in court, thus presenting "insurmountable hazards in pursuing" the IRS's basis for its deficiency assessment.⁸⁹ No further attempt to address the \$800,000 annual amortization expense into 1997 and subsequent tax periods are indicated.

83 IRS Timeline, *supra* note 81.

84 Tax Court Petition, *supra* note 7. In general, the purchase price allocated to intangible assets acquired in connection with the acquisition of a trade or business must be capitalized and amortized over a 15-year period under Internal Revenue Code section 197.

85 Tax Court Petition, *supra* note 7.

86 IRS Notice of Proposed Adjustment, *supra* note 9.

87 Tax Court Petition, *supra* note 7.

88 Memorandum from Gerald A. Richards, International Examiner, Internal Revenue Service, to Bill Bissell, Houston District Counsel, Internal Revenue Service (Dec. 21, 1999) (Exhibit 41).

89 Appeals Memo and Case Memo, *supra* note 18; *See also* Internal Revenue Service, Case Decision Data, IRS Appeals, Schedule of Adjustments 10 (Oct. 10, 2000) (Exhibit 42); Puerto Quetzal Power Corp. v. Commissioner, Docket No. 17311-99 (Nov. 11, 1999) (Exhibit 43) (On September 28, 2000, the U.S. Tax Court ordered and decided no deficiencies or overpayment based on an agreement of the parties.).

Internal Revenue Service Referral Procedures

In May 1999, the IRS referred its concerns about potential violations of FCPA to the DOJ⁹⁰ and the SEC⁹¹ as provided in section 6103 of the Internal Revenue Code (IRC). The IRS specifically requested further communication in the referral letter, stating:

In order for us to properly assess the usefulness of the information we are providing, we would appreciate knowing the final disposition of any action taken as a result of this referral. Our need for feedback on matters such as this is not diminished or affected by the passage of time.⁹²

Both agencies promptly acknowledged the referral,⁹³ but it does not appear that either agency took any further action. Perhaps this inaction is exacerbated by Section 6103, the provision in the IRC that protects taxpayer confidentiality. Specifically, section 6103 requires additional steps in the information gathering process to ensure taxpayer privacy protection.

Prior to 1976, tax returns were considered public records, subject to disclosure by executive order. In 1976, following the actions of the Nixon White House, IRC section 6103 was amended in the Tax Reform Act of 1976⁹⁴ to protect tax returns and tax return information from misuse.⁹⁵

Section 6103 embodies the policy that returns are confidential, and provides that returns and return information may not be disclosed by the IRS, other Federal employees, State employees, and certain others having access to the information except as provided in section 6103. Section 6103 also contains a number of exceptions to this general rule of nondisclosure which authorize disclosure in particular circumstances. Section 6103 imposes recordkeeping and safeguard requirements to protect the confidentiality of returns and return information. Criminal and civil sanctions apply under the Code to the unauthorized disclosure or inspection of returns and return information.⁹⁶

There are exceptions to the general rules of nondisclosure. One exception permits disclosure of returns and return information to officers and employees of Federal agencies for the administration of Federal non-tax criminal laws subject to the restrictions imposed by Section

90 Letter from Paul Cordova, District Director, Department of Treasury, Internal Revenue Service, to The Honorable Janet Reno, Attorney General (May 21, 1999) (Exhibit 44) [hereinafter IRS Letter to DOJ].

91 Letter from Paul Cordova, District Director, Department of Treasury, Internal Revenue Service, to The Honorable Arthur Levitt, Chairman, Securities and Exchange Commission (undated) (Exhibit 45) [hereinafter IRS Letter to SEC].

92 See IRS Letter to DOJ, *supra* note 90; IRS Letter to SEC., *supra* note 91.

93 See Letter from Peter Clark, Deputy Chief, Fraud Section, United States Department of Justice, to Paul Cordova, District Director, Internal Revenue Service (undated but stamped received by the IRS June 29, 1999) (Exhibit 44); Letter from Kevin J. Horn, Attorney, Division of Enforcement, United States Securities and Exchange Commission, to Paul Cordova, District Director, Internal Revenue Service (June 9, 1999) (Exhibit 45).

94 Pub. L. No. 94-455 (1976).

95 JOINT COMMITTEE ON TAXATION, STUDY OF PRESENT-LAW TAXPAYER CONFIDENTIALITY AND DISCLOSURE PROVISIONS AS REQUIRED BY SECTION 3802 OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998, VOLUME I: STUDY OF GENERAL DISCLOSURE PROVISIONS, 3-4 (Jan. 28, 2000) [hereinafter JOINT COMMITTEE 6103 STUDY].

96 JOINT COMMITTEE 6103 STUDY, *supra* note 95, at 3-4.

6103(i)(1) through (i)(7). Section 6103(i)(3)(A) permits the IRS to disclose in writing, return information (other than taxpayer return information) which may constitute evidence of a violation of a Federal non-tax criminal statute to the extent necessary to apprise the head of the appropriate Federal agency charged with enforcement responsibility.

Based on the above provisions, the IRS established specific procedures and guidelines for referrals to other federal agencies. The IRS procedure in effect when the Enron referral was made to DOJ and the SEC was set forth in Order No. 156 (Rev. 15) Chief Counsel Directives Manual (30)30 and Internal Revenue Manual Handbook 1.3.28.7 Service Initiated Disclosures of Return Information Concerning Nontax Criminal Violations.

Conversely, if a Federal agency seeks information from the IRS, Section 6103(i)(1) authorizes disclosure of return or return information. The Federal agency must be enforcing a non-tax criminal law and must obtain an ex parte court order. The Attorney General, Deputy Attorney General, Assistant Attorney Generals, any United States attorney, Independent Counsels, or an attorney in charge of an organized crime strike force may authorize an application to a Federal district court judge or magistrate for such an order. The judge or magistrate may grant the order if he determines on the basis of the facts submitted in the application that:

- (1) there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed;
- (2) there is reasonable cause to believe that the return or return information is or may be relevant to a matter relating to the commission of such act; and
- (3) the return or return information is sought exclusively for use in a Federal criminal investigation or proceeding concerning such act, and the information sought cannot be reasonably obtained, under the circumstances, from another source.⁹⁷

Thus, in order for agencies to obtain additional information from the IRS, they must comply with Section 6103 (i)(1), and obtain court approval.. Disclosures under section 6103(i)(1) included the following:⁹⁸

Federal Agency	Number of Disclosures in 2000	Number of Disclosures in 2001
U.S. Attorneys	39,760	1,313
Drug Enforcement Agency	767	668
Federal Bureau of Investigation	2,845	2,300
Other	4,175	2,140
Total	47,547	6,421

⁹⁷ IRC section 6103(i)(1)(B).

⁹⁸ Internal Revenue Service, Disclosure Report for Public Inspection for Calendar Year 2000 and 2001.

Additionally, as a condition for receiving returns and return information under section 6103(i), recipients (e.g., referral agencies) are required, among other things:

[to] restrict, to the satisfaction of the Secretary [of the Treasury], access to returns and return information only to persons whose duties and responsibilities require access and to whom disclosure may be made under the provisions of this title [Title 26].

Finally, IRC section 6103(b)(8) defines disclosure as the “making known” of a return or return information. Therefore, when tax returns and tax information originate with the IRS, there is no “disclosure” (within the meaning of IRC section 6103(b)(8)), in returning information to the IRS. Thus, it is within the law for an agency receiving information from the IRS to discuss such information with IRS personnel.

Department of Justice Procedures For Handling Referrals from the IRS

The DOJ does not have procedures or timelines for handling criminal referrals from the IRS or any other agency.⁹⁹ Nonetheless, the DOJ’s Criminal Resource Manual 1015 provides that:

Allegations of criminal violations of the Foreign Corrupt Practices Act (FCPA) are generally investigated by the Federal Bureau of Investigation (FBI), under the supervision of the Fraud Section of the Criminal Division. Investigations of allegations of civil violations of the record keeping and antibribery provisions by issuers may be investigated by the United States Securities and Exchange Commission (SEC). These civil investigations may result in a criminal referral to the Criminal Division.

It is important to realize that although the FBI is the primary investigative agency authorized to conduct investigations of FCPA allegations and is required by its internal regulations to bring any allegation of a violation of the FCPA to the Criminal Division, FCPA allegations may arise in a number of contexts, including agency audits, such as those conducted by the Department of Defense and the inspectors general of other agencies. When such allegations are brought to the attention of any Department of Justice attorney, including Assistant U.S. Attorneys, they must immediately be referred to the Fraud Section of the Criminal Division.¹⁰⁰

Securities and Exchange Commission Procedures For Handling Referrals from the IRS

While the SEC does have the authority to “investigate past, ongoing, or prospective violations of the federal securities laws, SEC rules or regulations, and self-regulatory organizations,”¹⁰¹ the SEC could not provide any procedure for handling IRS referrals.

99 Telephone Interview with Faith Burton, Special Counsel, Office of Legislative Affairs, Department of Justice (Sept. 12, 2002).

100 U.S. Department of Justice, Criminal Resource Manual, at http://www.usdoj.gov:80/usao/eousa/foia_reading_room/usam/title9/crm01015.htm.

101 Securities and Exchange Commission, Enforcement Training Program I (2001) *reprinted within* William McLucas et al., *A Practitioner’s Guide to the SEC’s Investigative and Enforcement Process*, 70 TEMP. L. REV. 53 (1997) [hereinafter SEC Enforcement, Law Review].

The staff of the SEC Enforcement Division conducts SEC investigations. At the beginning of an investigation, they will:

- Obtain information about the individuals or entities connected with the investigation from public and internal sources including: public filings, such as registration statements, annual and quarterly reports and Forms 3, 4, and 5; SEC and national stock exchange computer surveillance systems; news stories; Who's Who; Standard & Poor's; and the Internet
- Gather and analyze relevant facts
- Analyze applicable legal theories
- Develop a plan of investigation¹⁰²

The SEC conducts financial fraud and financial statement investigations. "These investigations focus on frauds accomplished through the use of false financial information and the failure to disclose material facts relating to a public company's financial condition."¹⁰³ The investigation generally includes gathering the independent public accountants relevant workpapers, and the company's relevant documents. Additionally, investigators subpoena documents from banks, creditors, customers, and others with a business relationship with the issuer. After analysis of such documents, the staff take testimony from appropriate personnel of the issuer and the independent public accountants.¹⁰⁴

The law contemplates communication between the SEC and the DOJ. Federal securities laws allow parallel proceedings for both civil and criminal enforcement. In practice, SEC investigations and proceedings occur simultaneously with DOJ or other federal and state agency enforcement activity.¹⁰⁵

Possible Explanations for Apparent Failure to Act

The Department of Justice and the Securities and Exchange Commission apparently failed to act on the IRS referral and failed to reply to the IRS's request for information regarding the final disposition of the referral. The DOJ and the SEC may not have investigated the IRS referrals because of: (1) a lack of specified procedure and (2) a possible lack of understanding of IRC section 6103. As previously stated, Section 6103 enables an agency responding to an IRS referral to gather more information from the IRS, with minimal obstacle, while still protecting taxpayer privacy.

102 SEC Enforcement, Law Review, *supra* note 101, at 62.

103 SEC Enforcement, Law Review, *supra* note 101, at 64.

104 SEC Enforcement, Law Review, *supra* note 101, at 65.

105 SEC Enforcement, Law Review, *supra* note 101, at 100.

III. Multilateral Financing and Insurance.

Enron used World Bank funds and funds from U.S. taxpayer supported agencies and lending organizations to finance the Guatemalan power project as well as the questionable payments to Sun King. The World Bank and the U.S. Department of Transportation Maritime Administration provided financing and the Overseas Private Investment Corporation (OPIC) provided political risk insurance.

World Bank

The World Bank, formally known as the World Bank Group, is one of the world's largest sources of development assistance. The World Bank is comprised of five institutions and each institution plays a role in the overall organization's mission to fight poverty and improve living standards for the people in the developing world. In Fiscal Year 2002, the World Bank provided \$19.5 billion in loans to its client countries and worked in more than 100 developing economies.¹⁰⁶

Enron received financing through one of the five World Bank institutions. The World Bank, through its International Finance Corporation (IFC), provided approximately \$761 million in financing for Enron's overseas operations.¹⁰⁷ In March 1993, IFC approved \$71 million to finance the Guatemala Project.¹⁰⁸

U.S. Department of Transportation, Maritime Administration

The Federal Ship Financing Program (Title XI of the Merchant Marine Act of 1936) provides for a full faith and credit guarantee by the U.S. Government of debt obligations issued by 1) U.S. citizen shipowners for the purpose of financing or refinancing U.S. flag vessels constructed or reconstructed in U.S. shipyards; 2) non U.S. citizen shipowners for the purpose of financing or refinancing foreign flag vessels constructed or reconstructed in U.S. shipyards; or 3) U.S. shipyards for the modernization and improvement of their facilities.¹⁰⁹

¹⁰⁶ World Bank Group, <http://www.worldbank.org> (2002).

¹⁰⁷ Enron's Pawns, *supra* note 4, at 15.

¹⁰⁸ IFC Investment Agreement, *supra* note 5.

¹⁰⁹ MARAD Letter, *supra* note 6.

The Maritime Administration (MARAD) approved \$198 million in financing for four separate Enron affiliates, including \$98 million for the Guatemala Project as follows:¹¹⁰

Project	Financing	Date	Comment
Puerto Quetzal Power Corporation	Approved \$25 million	May 16, 1994	<ul style="list-style-type: none"> • Joint venture with King Ranch Oil and Gas, Inc. • Enron chose not to close the transaction and used alternative financing
Smith/Enron Cogeneration Limited Partnership	Approved \$50 million Outstanding \$27.2 million	Dec. 22, 1995	<ul style="list-style-type: none"> • Total cost of project \$204.3 million • Co-financed with World Bank (International Finance Corporation), Commonwealth Development Corporation, and DEG-Deutsche Investitions-Und-Entwicklungsgesellschaft mbH
Empresa Energetica Corinto, Ltd	Approved \$50 million Outstanding \$41.34 million	Dec. 28, 1998	<ul style="list-style-type: none"> • Joint venture between a wholly owned subsidiary of Enron and the Centrans Group
Puerto Quetzal Power LLC	Approved \$73 million Outstanding \$66.7 million	Sept. 21, 2000	<ul style="list-style-type: none"> • Financed the construction of one barge mounted power plant operating off the coast of Guatemala and two additional power barges and onshore facilities • Co-financed with OPIC providing \$50 million

Overseas Private Investment Corporation

The mission of the Overseas Private Investment Corporation (OPIC) is to facilitate the investment of private capital from the United States to emerging markets (less developed countries/areas and countries in transition from non-market to market economies).¹¹¹

¹¹⁰ MARAD Letter, *supra* note 6.

¹¹¹ 22 U.S.C. § 2191.

OPIC accomplishes this mission by selling political risk insurance and providing long-term financing to U.S. businesses investing in over 140 developing countries.¹¹² Although OPIC is an agency of the U.S. government, it operates on a self-sustaining basis from fees paid on its insurance products and premiums received on its financing products, with no net cost to the U.S. taxpayer. Excess collections are maintained as reserves, which are composed entirely of non-tax dollars.¹¹³

OPIC political risk insurance provides coverage against three hazards: inconvertibility, expropriation, and political violence. In the event OPIC makes a claim payment, the payment comes from OPIC reserves. Once OPIC makes a payment to an insured, it makes every effort to secure reimbursement from the foreign government in question. Historically, OPIC has recovered 94 percent of claims settled.¹¹⁴

Enron, as with any insured, would have had to demonstrate that it was entitled to compensation in the amount claimed. While Enron purchased more than one insurance contract, OPIC had limited its loss exposure to less than the sum of all of these contracts. Enron's insurance contracts were subject to an overall stop loss agreement, which reduced the aggregate amount OPIC could be required to pay on the ten¹¹⁵ Enron contracts to \$204 million, an amount that is less than the sum of the individual contract amounts.¹¹⁶

With respect to OPIC financing, it is important to recognize that OPIC loans are generally made to a project company located in a developing country, with loan repayments coming from the revenues of that company rather than from the sponsors. Thus, project sponsors such as Enron are *not* OPIC borrowers and OPIC is *not* ordinarily a creditor of a project sponsor. Nevertheless, as of September 30, 2001, Enron was the largest OPIC project sponsor, with \$464 million in outstanding loan balances guaranteed by OPIC.¹¹⁷

OPIC's programs are backed by the full faith and credit of the United States government. As such, mechanisms are in place that would allow OPIC to get funding from the U.S. Treasury should OPIC reserves be inadequate to pay claims (Section 235(d) of the Foreign Assistance Act).¹¹⁸ OPIC has never had to call on the U.S. Treasury to cover a loss. With \$4.5 billion in reserves to cover any future losses OPIC may incur in its insurance or financing programs, and with its history of recovery on insurance claims, according to OPIC president, "it is unlikely OPIC will ever have to."¹¹⁹

112 Letter from Peter S. Watson, President and Chief Executive Officer, Overseas Private Investment Corporation, to The Honorable Charles E. Grassley, Ranking Member of the Senate Committee on Finance 1 (March 15, 2002) (Exhibit 46) [hereinafter OPIC Letter (March)] (Currently, OPIC has reserves of \$4.5 billion.).

113 OPIC Letter (March), *supra* note 112, at 1.

114 OPIC Letter (March), *supra* note 112, at 4.

115 OPIC Letter (Feb.), *supra* note 4, at Appendix 2B.

116 OPIC Letter (March), *supra* note 112, at 4.

117 OPIC Letter (March), *supra* note 112, at 8.

118 OPIC Letter (March), *supra* note 112, at 5.

119 OPIC Letter (March), *supra* note 112, at 6.

Federal law authorizes criminal penalties for fraud with respect to OPIC.¹²⁰ As such, anyone who knowingly makes any false statement or report . . . for the purpose of influencing in any way the action of OPIC with respect to any insurance, reinsurance, guarantee, loan, equity investment, or other activity of the Corporation is subject to the penalty.¹²¹

Under 18 U.S.C. § 1001, criminal liability may flow from knowingly and willfully falsifying, concealing, or covering up by any trick, scheme, or device a material fact; making any materially false, fictitious or fraudulent statement or representation; or making or using any false writing or document, knowing that it contains a materially false, fictitious, or fraudulent statement or entry.¹²²

Political Risk Representations Made by Enron

In its 1992 preliminary information memorandum provided to potential creditors and investors, Enron represented the electricity market in Guatemala as one in which demand for electricity was relatively unaffected by price increases. Enron also represented that the political environment was one in which government policy is “designed to limit inflation, encourage foreign investment, and privatize public sector companies in a manner that does not cause major de-stabilization.” Enron stated that Empresa’s “financial data, as audited by Arthur Anderson & Co., reflects strong leadership and responsible decision-making”¹²³ and described Empresa’s history and relationship to INDE (the government agency that owned 91.7 percent of Empresa).¹²⁴ The memoranda, however, do not mention the severe criticisms of INDE by a blue ribbon commission on privatization established by Guatemalan President Jorge Serrano.¹²⁵

In contrast to this rosy description, the Guatemalan political environment was deteriorating rapidly and the price of electricity was a very important factor. In August 1991, in preparation for privatization, President Serrano wanted to reduce government subsidies for electricity, and raised electricity prices by 47 percent. In July 1992, President Serrano’s blue-ribbon commission drafted a bill to reform and restructure INDE. The bill restructured INDE’s Board of Directors and gave the Board, instead of President Serrano, the authority to name the President of INDE. The legislature passed the bill, but President Serrano vetoed it. Instead, Serrano instituted his own privatization plan by executive decree.¹²⁶

Enron’s Representations to OPIC Regarding Questionable Payments.

120 22 U.S.C. § 2197(n).

121 Maximum penalties include a fine of not more than \$1 million, or imprisonment for not more than 30 years, or both. See Memorandum Congressional Research Service, Elizabeth B. Bazan, Legislative Attorney American Law Division, to Senate Finance Committee (April 22, 2002) (Exhibit 47) [hereinafter CRS Penalties Memo].

122 Maximum penalties include a fine under 18 U.S.C. § 3571 or imprisonment for not more than 5 years, or both. See CRS Penalties Memo, *supra* note 121.

123 Enron Memo to OPIC, *supra* note 15, at 46-50.

124 DICTATING DEMOCRACY, *supra* note 10, at 98.

125 Enron Memo to OPIC, *supra* note 15.

126 DICTATING DEMOCRACY, *supra* note 10, at 99. (As noted *supra* note 43, President Serrano’s appointee in that position, Alfonso Rodriguez Anker, who also served as the Chairman and CEO of Empresa, was the subject of congressional investigations.)

In 1992, Enron applied for political risk insurance from OPIC. In a preliminary information memorandum, Enron valued the cost of the 6 percent Sun King obligation at more than \$63 million over the 15-year life of the contract in the Guatemala Project. Those payments constituted 46.45 percent of the estimated Project cash flow.¹²⁷

Based on the same Enron Project projected financial statements, the value of the original Texas-Ohio Power (TOP) agreement with Sun King (16 percent of capacity payments and 21 percent of energy payments) was estimated to be worth over \$200 million. Thus, the percentage of Project revenues TOP committed to Sun King did not allow the Guatemala Project to achieve an economic rate of return.¹²⁸ As a result, the renegotiated 6 percent Sun King commitment allowed the Guatemala Project to achieve a rate of return acceptable to Enron, to the World Bank, and to the Guatemala Project creditors.¹²⁹

In 1992, in its preliminary information memorandum,¹³⁰ Enron described Sun King, under the section for “Royalty Participants,” as the originators of the Guatemala Project, and as:

[A] small group of Guatemalan businessmen representing sugar, coffee and shipping interests, attempting to enhance Guatemala’s economic growth prospects by solving its acute power shortages. This group (“Sun King”), together with a local electro-mechanical engineering firm, located Texas-Ohio Power . . . and assisted them in negotiations with EEGSA [Enron/Empresa], Puerto Quetzal, and with engineering and financial entities.¹³¹

The payments from TOP to Sun King were described as:

[A] monthly royalty payment in lieu of an equity interest in the Project in return for [Sun King’s] role in developing the Project, negotiating the PPA with EEGSA [Empresa], and ongoing assistance with permitting and port arrangements. Sun King originated, and, helped persuade convinced [sic] the Guatemalan government and EEGSA [Empresa] of the role and viability of privatized power in Guatemala, and provided initial development capital and services to TOP.¹³²

The preliminary information memorandum further stated that TOP had assigned the 6 percent royalty to Sun King, and “Sun King has continued to play an instrumental advisory role to Enron, particularly with respect to permitting and port relations.”¹³³

127 Enron Memo to OPIC Cash Flow, *supra* note 17; *See also* Enron Memo to OPIC, *supra* note 15.

128 Haug Interview, *supra* note 77.

129 Enron Memo to OPIC, *supra* note 15, at 81.

130 Enron Memo to OPIC, *supra* note 15, at 81.

131 Enron Memo to OPIC, *supra* note 15, at 81.

132 Enron Memo to OPIC, *supra* note 15, at 81.

133 Enron Memo to OPIC, *supra* note 15, at 51; *See also* Overseas Private Investment Corporation, Questions for Enron Power Development Corp.’s Richard A. Lammers 1, question 4 (June 9, 1992) (Exhibit 48) (OPIC submitted questions for response by Richard A. Lammers of Enron Power Development Corp. OPIC asked about Sun King and the 6 percent payments, specifically whether it was 6 percent of net or gross returns. In response, “6% of gross” was circled.); OPIC Questions to Lammers, at 2, question 13 (A hand-written response also included the following

Thus, Enron benefited from taxpayer support and multilateral organization support to extend its international reach, including the Guatemalan power project with its questionable payments.

statements: "They are local Guatemalans with a stake in the Project. Still acceptable returns." and "in contract before it was purchased."
Calculations based on the information provided to OPIC show that the 6 percent payments, shown as "Guatemalan share of revenue.").

IV. Compensation Through Bonuses and Stock Options Based on Financing.

Bonuses and stock options were awarded when project financing was obtained, rather than upon successful completion of a project.

One of the motivating factors overlaying Enron's foreign project development was the incentives (bonuses) awarded to its developers (employees and officers) for project successes. Enron's definition of project success may account for why Enron developers negotiated with an in-country group such as Sun King and dealt later with problems resulting from such sponsorship.¹³⁴

Enron/EDC adopted the Enron Development Corp. Project Participation Plan (the Plan).¹³⁵ The stated purpose of the Plan was:

[T]o provide a means whereby certain selected Employees . . . may develop a sense of proprietorship and personal involvement in the development and financial success of Enron Development Corp. (the "Company"), to attract and retain Employees of outstanding competence and ability, to encourage them to devote their best efforts to the business of the Company, and to reward them for outstanding performance benefiting the Company and its stockholders.¹³⁶

The "Plan Payment Date" refers to four potential payment dates:

- (1) the date upon which the construction of, improvements to, or refurbishment of such Project is complete ("construction date");
- (2) the closing of permanent limited recourse financing ("financial closure date");
- (3) the date that is six months after the commencement of commercial operations ("operation commencement date"); or
- (4) the date upon which occurs a transfer resulting, directly or indirectly, a decrease in Enron's aggregate direct or indirect ownership interest in such Project or assets ("transfer date").¹³⁷

Thus, success for the Guatemala Project was met by obtaining the \$71 million project funding from the International Finance Corporation (a division of World Bank).¹³⁸

134 Interview Rodney L. Gray, Consultant, in Houston, Tex. (September 17, 2002) (Mr. Gray was formerly the Vice President and Treasurer, Enron Corporation, and Chairman and Chief Executive Officer of Enron International) (Mr. Gray stated that he was not in favor of Enron International, Inc. awarding its developer bonuses at project (limited recourse) financial closure. Instead, he felt the bonuses should have some link to the eventual commercial success of a given project.).

135 Enron Development Corp. Project Participation Plan (effective Jan. 1, 1993 to Dec. 31, 1995) (EC 001936341-EC 001936371, Exhibit 49) [hereinafter Enron/EDC 1993 Participation Plan] (Effective January 1, 1996, the Plan was amended and restated, extending the term of the Plan until December 31, 2000.).

136 Enron/EDC 1993 Participation Plan, *supra* note 135, at 1 (EC 001936347).

137 Enron/EDC 1993 Participation Plan, *supra* note 135, at 2-6 (EC 001936350 through EC 001936352).

“Incentive Compensation” was payable under the Plan and, once awarded, the form of payment could be either cash, shares of common stock or a combination thereof.¹³⁹ “Fixed Participation Interests” awards applied to each project arising during the period an Award Agreement was in effect.¹⁴⁰ Recipients received these awards based on their supervisory role over Enron/EDC projects.¹⁴¹ In contrast, “Specific Participation Interests” awards applied to one or more specific projects.¹⁴²

Enron was unable to locate documentation for compensation, bonuses, and stock option awards for the Guatemala Project. However, an example of awards at Plan Payment Dates for Enron power project successes in Italy and Puerto Rico are summarized in the following table.¹⁴³

Project Name	Project Value	Project Value	Pool	Comments
Sarlux (Italy)	\$105.7 million	\$246.8 million	\$20 mil. (10% of NPV capped at \$20 mil.)	<ul style="list-style-type: none"> Plan Payouts capped at \$20 million Payouts total \$14.5 million for developers; \$5.5 million paid at financial close to other staff
EcoElectrica (Puerto Rico)	\$231.7			<ul style="list-style-type: none"> First Milestone Financial Closure Jan. 1998 Developers with fixed interests paid \$5,116,387 (does not include developer awarded a 1.5% interest); developers with variable interests paid \$5,108,874
EcoElectrica (Puerto Rico)		\$268.3 million		<ul style="list-style-type: none"> Second milestone payment approved for Feb. 2001 Developers with fixed interests paid \$4,272,923; developers with variable interests paid \$7,661,160
<p>Note: Participants can elect to (1) receive payment, in the form of cash and options, based on the current project net Project value, or (2) receive payments based on NPV at the time the project has been in operation for six months, or (3) upon a transfer date.</p>				

Enron’s compensation for specific projects focused on the attainment of financing rather than developing and completing a successful project. Thus, through cash and stock option bonuses, Enron executives received compensation at the beginning of a project, regardless of the success or failure of the project.

138 Investment Agreement, Puerto Quetzal Power Corp. and International Finance Corporation (March 31, 1993) (EC2 000036651 – EC2 000036700) [hereinafter IFC Loan]; See also Form 10K, *supra* note 69.

139 Enron/EDC 1993 Participation Plan, *supra* note 135, at 10 and 13 (EC 001936356 and EC 001936359).

140 Enron/EDC 1993 Participation Plan, *supra* note 135, at 8 (EC 001936354).

141 Interview of Rebecca P. Mark, in Houston, TX (Oct. 4, 2002).

142 Enron/EDC 1993 Participation Plan, *supra* note 135, at 8-9 (EC 001936354 - EC 001936355).

143 Compensation and Management Development Committee Meeting, Enron Corp. (August 9, 1999) (EC000101088; EC000102380; EC000102381; EC2000032349, on file with Senate Finance Committee).